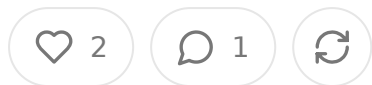


The Quiet Consolidation: How Private Equity Roll-Ups Are Reshaping Digital Health Returns

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Abstract

Private equity roll-ups have emerged as a dominant exit strategy in digital health, fundamentally altering the return profiles available to early-stage investors. This essay examines the mechanics of PE consolidation in healthcare technology, analyzes the economic implications for seed and Series A investors, and explores why traditional venture returns are increasingly rare in sectors where roll-ups dominate. Through

examination of recent transactions and platform strategies, we identify the structural factors that make digital health particularly susceptible to consolidation plays and discuss the strategic adjustments investors must make in response. Key findings suggest that while roll-ups provide liquidity events, they often compress returns for early investors while creating substantial value for PE firms through operational improvements, cross-selling synergies, and multiple arbitrage. The essay concludes with implications for portfolio construction and investment strategy in an era where the traditional power law distribution of venture returns is being disrupted by systematic consolidation.

Introduction

There is a peculiar irony in how healthcare technology companies exit today. We spend countless hours in diligence meetings discussing total addressable market measured in hundreds of billions, network effects that will supposedly create winner-take-all dynamics, and why this particular workflow automation tool will become the system of record for an entire specialty. Then, three to five years later, the company gets acquired by a private equity-backed platform for four times revenue in an all-cash deal that barely moves the needle for the fund. The entrepreneurs are happy having built something real and gotten liquidity. The late-stage investors are content having made a respectable return. But the seed investors, who took the risk when the company was just a deck and a dream, find themselves looking at a three-to-five return on a winner, when they needed ten-to-twenty times to make the portfolio work.

This pattern has become so common in digital health that it barely registers as noteworthy anymore. Behavioral health platforms, home health software compared to specialty pharmacy enablement tools, revenue cycle management solutions, and patient engagement applications are being systematically rolled up by private equity firms with names that most people outside of healthcare finance have never heard of. These are not the splashy acquisitions that make TechCrunch headlines. They are quiet consolidations that happen at eight to twelve times EBITDA, announced in press releases that emphasize strategic fit and market leadership, executed by firms

that have raised billions specifically to aggregate fragmented healthcare services software markets.

The rise of the roll-up as the dominant exit path in digital health represents a fundamental shift in how value is created and captured in healthcare technology not that these exits are bad, exactly. They provide liquidity, validate business models and often lead to better outcomes for customers as companies gain resources and scale. But they create a challenging dynamic for early-stage investors who have built their entire investment strategy around the possibility of outsized returns from a small number of breakout winners. When your winners exit at valuations that would have been considered modest failures in consumer internet, the entire venture market starts to strain under its own assumptions.

The Mechanics of Healthcare Roll-Ups

To understand why roll-ups have become so prevalent in digital health, it helps to understand the economics that make them attractive to private equity firms. The playbook is straightforward. A PE firm identifies a fragmented market where there are dozens or hundreds of small to medium-sized companies providing similar services or software to healthcare providers, payers, or life sciences companies. They acquire a platform company, typically one with strong management, decent market share, and proven unit economics. This becomes the foundation. Then they systematically acquire competitors, bolt-on adjacent capabilities, and integrate operations to drive margin expansion.

The value creation comes from several sources. First, there is cost synergy from consolidating back-office functions, eliminating duplicate overhead, and negotiating better terms with vendors. A platform company spending two million dollars annually on cloud infrastructure and software licenses can often absorb an acquisition with proportional increases in those costs. Second, there is revenue synergy from cross-selling products across a combined customer base. A company that sells revenue management software can upsell coding automation tools to the same hospitals. There is multiple arbitrage. If you can buy companies at six to eight times EBITDA

and sell the combined entity at twelve to fourteen times EBITDA, you create value simply through aggregation, even before operational improvements.

The math works particularly well in healthcare because the underlying businesses often have strong unit economics once they reach scale. A software company serving orthopedic practices might have gross margins of seventy-five to eighty percent, relatively sticky customer relationships, but it lacks the resources to expand beyond its niche or invest in product development. When that company is acquired by a platform with existing sales infrastructure, product development capabilities, and customer success teams, the incremental cost of supporting that business is modest while the revenue becomes part of a larger, more defensible portfolio.

Private equity firms have become increasingly sophisticated in how they execute roll-ups. The first generation of healthcare PE roll-ups, which began in earnest in the mid-two-thousands, focused primarily on provider services, physician practice management, and dental service organizations. The playbook was relatively crude: standardize practices, consolidate billing, and drive margin expansion through standardization. Many of these deals struggled because they underestimated the importance of physician autonomy and local market dynamics.

The current generation of roll-ups is more refined. Rather than trying to impose standardization from the top down, they often operate acquired companies as relatively independent business units while consolidating specific functions where scale matters. They invest in technology infrastructure that benefits all portfolio companies while allowing them to maintain their brands and customer relationships. They are also more strategic about sequencing acquisitions, often building out capabilities in a deliberate order to create a full-stack solution for a specific market segment.

Consider what has happened in behavioral health technology over the past five years. Multiple PE-backed platforms have emerged, each pursuing a slightly different strategy but all following the basic roll-up playbook. They start with a core electronic health record or practice management system that serves therapists or psychiatrists. Then they add telehealth capabilities through an acquisition. Then they add patient

intake and scheduling tools. Then they add billing and collections optimization. They add clinical decision support and measurement-based care tools. Each acquisition makes the platform stickier and harder to displace, while also providing opportunities to upsell existing customers.

The entrepreneurs who sell to these platforms often speak positively about the experience, at least initially. They gain access to resources they never had as independent companies: real marketing budgets, experienced executives who have scaled businesses before, and the ability to invest in product without worrying about runway. For founders who have been grinding for years to get to five or ten million revenue, the opportunity to be part of something larger and better-resourced is genuinely appealing, even if they give up some autonomy in the process.

Why Digital Health Became Roll-Up Territory

The proliferation of PE roll-ups in digital health is not accidental. Several structural characteristics of healthcare technology markets make them particularly amenable to consolidation strategies, and understanding these dynamics is crucial for investors trying to navigate the space.

Healthcare is fundamentally a market of markets, composed of countless niches defined by specialty, care setting, payer type, and geography. A software company serving dermatology practices has a completely different value proposition, sales motion, and competitive landscape than one serving cardiology practices, even though both are physician practice management tools. This fragmentation creates opportunities for companies to build defensible businesses serving narrow segments, but it also limits the size of any individual opportunity. A company that captures thirty percent of the dermatology practice management market might only be a ten million dollar revenue business, hardly the scale needed for a venture-style exit.

This fragmentation also means that the path to building a large, standalone business often requires expanding across multiple segments, which is operationally complex and capital-intensive. It requires building sales teams with different expertise,

developing features for different workflows, and managing the complexity of serving diverse customer bases with a single product and organization. Many companies find it easier to focus on dominating their initial niche rather than expanding horizontally, which makes them attractive acquisition targets for platforms trying to assemble multi-specialty solutions.

The other structural factor is that healthcare technology often struggles to achieve true winner-take-all dynamics. Unlike consumer internet businesses where network effects can create natural monopolies, most healthcare software markets support multiple viable competitors. Hospitals will often standardize on a single electronic health record vendor, but they will use dozens of different point solutions for scheduling, revenue cycle, care coordination, and analytics. Physician practices are even more fragmented, with different specialties gravitating toward different solutions based on workflow requirements and feature sets.

This means that being the market leader in a category does not necessarily translate into the kind of commanding market position that justifies venture-scale valuation. A company with twenty percent market share in a two billion dollar category is generating four hundred million in revenue if they captured all spending, but actual penetration is usually much lower. In practice, most digital health companies that go public or achieve large exits do so with a few hundred million in revenue and market shares in the single digits to low double digits. There are exceptions, of course, particularly in areas where network effects or switching costs are high, but they are rarer than in other technology sectors.

The regulatory and sales complexity of healthcare also plays a role. Enterprise software sales cycles in healthcare are notoriously long, often taking twelve to eighteen months from initial contact to signed contract. Implementation can take equally long, particularly for solutions that require integration with existing systems or changes to clinical workflows. This means that scaling a healthcare technology company requires substantial upfront investment in sales and customer success before revenue materializes, making the path to profitability longer and more capital-intensive than in other markets.

For venture capitalists, this creates a challenge. If you invest in a seed round at a million dollar valuation, you need the company to exit at three hundred million to one billion dollars to generate the returns that make early-stage investing worthwhile. If the realistic outcome for most companies in the space is an exit at one hundred to two hundred million dollars, the math simply does not work. You cannot build a successful venture portfolio when your winners return five to ten times instead of twenty to fifty times.

Private equity firms, by contrast, are perfectly positioned to create value in this environment. They are not looking for exponential growth and moonshot outcomes. They are looking for businesses with predictable cash flows, margin expansion opportunities, and the potential to drive returns through operational improvements and strategic consolidation. A roll-up strategy allows them to aggregate multiple modest-sized businesses into a platform that has the scale and market position to command premium valuations, while the underlying businesses continue generating the steady cash flows that make the investment thesis work.

The Returns Reality for Early Investors

The impact of PE roll-ups on early-stage investor returns is nuanced and deserves careful examination. On the surface, a liquidity event is a liquidity event, and anything that provides an exit should be welcomed. But when you dig into the actual numbers, the picture becomes more complicated.

Consider a typical scenario. A company raises a seed round of two million dollars at an eight million dollar post-money valuation. They raise a Series A of eight million dollars at a thirty million post, a Series B of twenty million at a hundred million post, and Series C of forty million at a two hundred and fifty million post. The company is growing nicely, has strong unit economics, and is approaching break-even. At that point, they get approached by a PE-backed platform that offers to acquire them for three hundred and fifty million in cash.

For the Series C investors who came in at two hundred and fifty million, this is a 25 percent markup in a year or two. Not spectacular, but reasonable. For the Series

investors at a hundred million, it is a three-and-a-half times return, which is solid. For the Series A investors at thirty million, it is nearly twelve times, which looks like a great outcome. But for the seed investors who came in at eight million post, it is about a forty-four times gross return on paper.

Now factor in dilution. Through subsequent rounds, the seed investors have likely been diluted from their initial twenty-five percent ownership down to perhaps ten to twelve percent by the time of exit, assuming they maintained their pro rata in later rounds. If they did not maintain pro rata, they might be down to five to seven percent. So that forty-four times paper return might actually be closer to fifteen to twenty times in reality for investors who fully maintained their position, or eight to twelve times for those who did not.

These are still decent returns, certainly better than most investment outcomes. But they are not the fifty to a hundred times returns that define true venture winners: ones that return entire funds and make careers. And more problematically, they are not large enough outcomes to make up for the inevitable losses and mediocre performers in a venture portfolio.

The traditional venture capital model assumes that most investments will fail, so you will return capital or generate modest returns, and a small number will generate massive returns that they more than compensate for all the failures. This power law distribution is fundamental to how venture portfolios are constructed and how financial economics work. If you are investing out of a hundred million dollar fund and making twenty investments, you need at least one or two investments that return the entire fund to deliver top-quartile performance. That typically means finding companies that exit at multi-billion dollar valuations.

When PE roll-ups become the dominant exit path, this dynamic breaks down. In a power law distribution where outcomes range from zero to fifty billion dollars, you get a more compressed distribution where most outcomes cluster between ten to loss and exits in the low hundreds of millions. The upside gets capped at levels that would have been considered disappointing a decade ago, while the downside remains

the same: zero. This is terrible for the risk-return profile of venture investing, particularly at the early stages where the probability of total loss is highest.

There is also a timing issue. PE roll-ups often happen earlier in a company's life than traditional venture exits through IPO or strategic acquisition by a large tech or healthcare company. A company might get rolled up when it is at fifteen to twenty million in revenue and growing thirty to forty percent year-over-year, rather than waiting to reach fifty to a hundred million in revenue and potentially commanding a much higher valuation. The PE buyer is willing to pay a premium to current revenue because they can see the path to operational improvements and cross-selling synergies, but that premium is not as large as the valuation multiple a company could achieve by continuing to scale independently.

This creates a challenging dynamic for boards and investors. On one hand, you have a concrete offer that provides liquidity and certainty. On the other hand, you have the theoretical possibility of a larger outcome if the company continues growing and either goes public or gets acquired by a strategic at a later stage. The problem is the path to that larger outcome requires more capital, more time, and more risk. In healthcare, the odds of actually achieving that outcome are lower than in other sectors.

Many investors have learned to adjust their expectations and investment criteria in response to this reality. They focus more on capital efficiency and the path to profitability, reasoning that if exits are going to be more modest, companies need to get there with less capital to generate acceptable returns. They prioritize businesses with strong unit economics and clear paths to break-even, rather than swinging for growth at all costs. They look for markets where the company can realistically capture a significant share and defend its position, rather than playing in massively fragmented spaces where consolidation is inevitable.

The Strategic Implications

The prevalence of PE roll-ups has several strategic implications for how investors should think about digital health opportunities. The first is that market selection

matters more than ever. If you are investing in a category where roll-ups are the outcome, you need to understand the dynamics that will determine valuation and be realistic about return potential. Some categories are more susceptible to roll-up dynamics than others.

Point solutions in fragmented markets are particularly vulnerable. If a company building workflow automation for a specific clinical specialty or administrative function, and the market can support multiple competitors, it is likely to become a roll-up at some point. The unit economics might be excellent, and the business might be growing steadily, but the ceiling on valuation is relatively low because the company is unlikely to achieve the scale and market position needed to go public or command strategic acquisition interest from large technology companies.

Platform plays that aggregate multiple capabilities or serve multiple customer segments are more defensible. A company that starts as a point solution but systematically expands its product portfolio and moves up the value chain can become something substantial enough to resist being rolled up or command premium valuations when it eventually sells. The challenge is that this requires significantly more capital and operational complexity than building a focused point solution.

Network effect businesses, where they exist in healthcare, remain attractive because they have the potential to achieve winner-take-all or winner-take-most dynamics. Patient marketplaces, provider networks, and data intermediaries that connect multiple parties can build defensibility that makes them less attractive for roll-up strategies and more attractive as standalone businesses or strategic acquisitions. The challenge is identifying which apparent network effects are real and which are illusory, and whether the network effects are strong enough to overcome the fragmentation and incumbency advantages that exist in healthcare.

The second implication is that capital efficiency becomes paramount. If exit valuations are going to be compressed relative to consumer internet or horizontal SaaS, companies need to get there with less capital to generate acceptable returns for early investors. This means being more disciplined about growth spending, achieving

profitability earlier, and avoiding the temptation to overspend on sales and marketing before product-market fit is truly proven.

This runs counter to the conventional wisdom in venture capital, which emphasizes growth at all costs and capturing market share before competitors. But in healthcare where sales cycles are long and markets are fragmented, premature scaling is often fatal. Companies that raise large rounds and build out expensive sales organizations before fully understanding their go-to-market motion often find themselves burnt through capital without achieving the growth rates that justify the investment. They then face a difficult choice: raise more capital at flat or down valuations, or sell to a PE buyer earlier than planned at a valuation that barely covers their capital raised.

The companies that generate the best returns for early investors, even in roll-up categories, are often those that stay lean longer and prove out their models with less capital. They might not grow as fast as companies that raise large rounds and invest aggressively in growth, but they maintain optionality and avoid the dilution that comes with multiple large rounds. When they do eventually sell, a larger percentage of the outcome accrues to early investors rather than being distributed across a corporate cap table with multiple layers of preferences.

The third implication is that investors need to be more thoughtful about fund strategy and portfolio construction. If healthcare technology investments are going to generate more compressed returns than other venture categories, funds need to adjust their models accordingly. This might mean deploying less capital per company, taking larger initial ownership positions to compensate for compressed exits, or constructing portfolios with more investments to increase the probability of finding outliers.

Some investors have responded by creating specialized healthcare funds with different economics than traditional venture funds. They might target lower returns but with a higher probability, charge lower management fees, or structure their funds with longer time horizons that allow companies to reach larger scale before exiting. Companies have moved toward growth equity strategies, investing later when business models are proven and risk is lower, accepting lower multiples in exchange for higher hit rates.

There is also a case for early-stage investors to be more actively involved in M&A processes and relationship-building with potential acquirers. In consumer internet and horizontal SaaS, exits often happen through inbound interest or competitive pressure run by investment banks. In digital health, where PE roll-ups are common, exits happen through relationships built over years between management teams, board members, and platform companies. Investors who understand the landscape of funded backed platforms in their portfolio companies' categories and can facilitate introductions and discussions add meaningful value beyond capital and advice.

Looking Forward

The rise of PE roll-ups in digital health is not a temporary phenomenon driven by a particular market cycle or availability of capital. It reflects fundamental structural characteristics of healthcare technology markets that are unlikely to change in the near term. Fragmentation, regulatory complexity, long sales cycles, and the difficulty of achieving true network effects will continue to create environments where consolidation makes strategic sense.

This does not mean that venture-scale outcomes are impossible in digital health. There are categories where companies can build truly large, defensible businesses that command premium valuations. Infrastructure plays that sit beneath multiple healthcare workflows, data platforms that aggregate information from multiple sources, and marketplaces that connect supply and demand in healthcare services all achieve meaningful scale. Companies that successfully navigate regulatory pathways to become embedded in provider workflows or payer operations can build switching costs that protect them from competition and make them valuable strategic assets.

But investors need to be realistic about base rates and probabilities. If nine out of ten successful digital health companies exit through PE roll-ups rather than IPOs or strategic acquisitions, investment strategies need to account for that reality rather than assuming every investment has the potential to be the exception. This means being more selective about which opportunities to pursue, more disciplined about

valuation and ownership, and more creative about fund structures and portfolio construction.

It also means being intellectually honest about what success looks like in digital health investing. A portfolio that generates consistent three to five times returns on capital with occasional eight to twelve times winners might not produce the same headline returns as consumer internet funds with their rare hundred times exits. It can still be a perfectly good business that generates strong absolute returns for investors. The challenge is aligning expectations between general partners and limited partners about what is achievable and how to measure success.

For entrepreneurs, the prevalence of roll-ups creates different considerations. Building a company that will eventually be acquired by a PE-backed platform is inherently less valuable or meaningful than building one that goes public or gets acquired by a major technology company. The exit might be smaller and less celebrated, but if the company creates value for customers, generates returns for investors, and provides rewarding outcomes for employees, it is still a successful venture.

The key is being honest about the likely trajectory from the beginning and making strategic decisions accordingly. If you are building a point solution in a fragmented market, embrace capital efficiency and focus on profitability rather than growth costs. Build relationships with potential acquirers early and understand what they value in acquisition targets. Structure your cap table to ensure that a modest exit generates meaningful returns for employees and early investors. And be realistic about the trade-offs between maintaining independence and joining a larger platform that can provide resources and scale.

The healthcare technology landscape is evolving in ways that challenge traditional venture capital assumptions about how value is created and captured. Private equity roll-ups are not disrupting that process as much as they are revealing tensions that have always existed between the venture model and the realities of healthcare markets. Understanding these dynamics and adjusting strategies accordingly is

essential for investors and entrepreneurs who want to build successful businesses and generate strong returns in an era of consolidation.

The companies that will succeed in this environment are those that understand their market position, build sustainable business models, and make strategic decisions aligned with realistic exit possibilities rather than aspirational unicorn dreams. Investors who will succeed are those who adjust their expectations, portfolio construction, and fund strategies to match the actual distribution of outcomes rather than hoping for power law distributions that rarely materialize in healthcare. And entrepreneurs who will build meaningful companies are those who focus on solving real problems for customers, building defensible businesses, and creating value regardless of whether the exit happens through a PE roll-up or some other path.

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